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COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

AT RICHMOND, MARCH 3, 1999

COMMONWEALTH OF VIRGINIA, ex rel.

GEORGE M. HUDGINS, et al.

v.

CASE NO. PUE960133

SYDNOR HYDRODYNAMICS, INC.

FINAL ORDER

In a petition filed on July 24, 1996, the First Colony Civic Association requested that the Commission assume jurisdiction, pursuant to § 13.1-620(G) of the Code of Virginia, to determine if Sydnor Hydrodynamics, Inc.'s, ("Sydnor" or "the Company") rates were reasonable and its service adequate for the First Colony water system in James City County, Virginia. That petition was signed by 85 percent of the system's customers.

Sydnor's current rates challenged in this proceeding include: a bimonthly minimum charge of \$33.00 which includes 4,000 gallons of usage per month and a \$4.125 per 1,000 gallons charge for all usage in excess of 4,000 gallons.

Sydnor's current rates were established by a contract with the original developer of the First Colony subdivision, effective July 15, 1963. That contract established the original water rates and authorized Sydnor to increase rates periodically

in accordance with a cost of living escalator tied to the increase in the Consumer Price Index.

On March 31, 1997, the Commission entered a Consent Order reciting the agreement of Sydnor, Staff and the Division of Consumer Counsel, Office of the Attorney General, to make rates interim, subject to refund, effective April 1, 1997.

On April 15, 1997, the Commission issued an order scheduling a hearing in the matter and requiring the Company to implement a cost tracking procedure on a going-forward basis. The Commission also required the Company to submit financial data for the First Colony system based on a six-month period ending June 30, 1997.

A hearing was held on November 5, 1997, before Chief Hearing Examiner Deborah V. Ellenberg. Counsel appearing were John D. Sharer, Esquire, for the Company, and Marta B. Curtis, Esquire, and C. Meade Browder, Jr., Esquire, for the Commission's Staff.

Three public witnesses appeared and offered testimony at the hearing. One witness expressed concern with service quality, notably extended outages. Another expressed skepticism with Sydnor's allocations of costs among its many systems, and the final witness noted issues of service reliability, reasonableness of rates, and customer relations.

At the hearing the Company challenged the Commission's jurisdiction in this matter. The Company argued that the Commission's jurisdiction over unregulated water companies was limited to the provisions of Chapter 10.2 of Title 56 of the Code of Virginia. It also argued that any attempt to adjust the Company's rates set pursuant to a private contract would violate the contract clauses of the constitutions of the United States and Virginia. Further, the Company argued that any effort to reduce Sydnor's rates would result in an unconstitutional taking without due process or just compensation. Staff asserted that the Commission had clear authority to assert jurisdiction over the Company and proposed several adjustments to determine the Company's revenue requirement.

There were also accounting and quality of service issues in controversy at the hearing. The Company disagreed with Staff's adjustments reducing the Company's rate case expense, expense related to the controller's time spent on tracking costs for the First Colony system, salary expense, leak expense, uncollectible expense, meter expense, and other miscellaneous expenses. Staff also took exception with the Company's proposal to add two temporary surcharges to recover the costs of this proceeding and to recover costs associated with the tracking and reporting of First Colony system expenses.

The Company also took issue with Staff's recommendation that the Commission retain jurisdiction over the Company for two years in order to monitor the Company's service. While the Company did not oppose Staff's recommendation that the Company be required to implement toll-free calling for service problems, it argued that the additional cost associated with implementing such service should be included in its cost of service.

On October 7, 1998, the Hearing Examiner filed her Report. In her Report, she found that:

- (1) The use of a six-month test period ending June 30, 1997, is proper in this proceeding;
- (2) The Company's annual operating revenues, for the First Colony system, after all adjustments, were \$82,995;
- (3) The Company's annual operating revenue deductions for the First Colony system, after all adjustments, were \$76,564;
- (4) The Company's net operating income for the First Colony system, after all adjustments, was \$6,431;
- (5) The Company's current rates produce a return on adjusted rate base of 40.70%;
- (6) The Company's First Colony system adjusted rate base is \$15,802;
- (7) The Company's current rates are unjust and unreasonable because they will produce revenue which would generate a return on rate base of 40.70%;

(8) The Company requires \$78,995 in gross annual revenues to earn a 24.99% return on rate base;

(9) The Company should be required to refund, with interest, all revenues collected under its interim rates in excess of the amount found just and reasonable;

(10) The Company shall maintain a detailed record of service interruptions, including the date, the location and a brief description of the interruption;

(11) The Company shall implement toll-free calling for after business hours service problems; and

(12) The Commission should retain jurisdiction over Sydnor for two years from the date of the final order.

The Examiner recommended that the Commission enter an order that adopts the findings in her Report; reduces the Company's rates as described in the Report; and directs the refund of all amounts collected under interim rates in excess of the rate increase found just and reasonable therein.

In her discussion of the jurisdictional issues, the Examiner relied on the 1974 amendment to § 13.1-620(G) and Commission precedent¹ to support her finding that the Commission had authority to exercise jurisdiction over Sydnor. The Examiner rejected Sydnor's argument that the 1974 amendment is

¹ Report at 7 (discussing Application of Oak Hill Water Co., Case No. 19475, 1975 S.C.C. Ann. Rep. 206; Commonwealth ex rel. State Corp. Comm'n v. Broadview Water Works, Inc., Case No. 19543, 1976 S.C.C. Ann. Rep. 107).

unconstitutional and in conflict with § 56-265.11. The Examiner noted that, even if a conflict exists, § 13.1-620(G) would prevail as it was enacted subsequent to the enactment of § 56-265.11.

In discussing her finding that there were no contract clause violations, the Examiner relied on the overriding public policy interest to assure that an essential service is being provided at fair rates as articulated in the Oak Hill Water Company and Broadview Water Works cases. The Examiner found no improper taking if the Commission accepted the reduced rates recommended in her Report as there was no denial of due process and her recommendation would fairly compensate the Company. The Examiner also found that Sydnor's interests did not outweigh public interest considerations in this instance.

Pursuant to a Commission order entered on October 21, 1998, the Company filed comments and exceptions to the Report of the Hearing Examiner on November 12, 1998. The Company took exception with the Examiner's finding that the Commission had jurisdiction over the proceeding pursuant to § 13.1-620(G) and requested that the Commission dismiss the case with prejudice.

If the case were not dismissed, it was the Company's position that the Commission should find First Colony's rates just and reasonable and include \$39,000 of rate case expense in its cost of service. The Company also urged the Commission to

adopt First Colony's adjustment to normalize test year expenses for leak repairs; to include the adjustment expensing the replacement of water meters; and to adjust cost of service by \$55.00 per month to provide for the cost of implementing the Hearing Examiner's recommendation regarding the establishment of toll-free, twenty-four hour calling service.

The Company took exception with the Examiner's recommendation that the Commission retain jurisdiction over the First Colony System for two years. If the Commission retains such jurisdiction, the Company requested that it clarify that such jurisdiction applies solely to the First Colony water system and not to the Company as a whole. The Company also requested that, if such jurisdiction were retained, water rates for the First Colony system be governed by the 1963 contract and the rate increase provisions of such contract.

NOW THE COMMISSION, having considered the record, the Examiner's Report and the comments thereto, as well as the applicable law, is of the opinion that the findings and recommendations of the Examiner, with the exceptions noted below, are reasonable and will be adopted.

We agree with the Examiner's finding that the Commission has jurisdiction over this matter. The Examiner's Report did not contain a lengthy discussion of the constitutional issues raised by Sydnor. Given the vigor with which the Company puts

forth its constitutional arguments, we will address these issues in some detail.

The contract clauses of the United States Constitution² and the Virginia Constitution³ protect against the same fundamental invasion of rights, and judicial interpretations of the two clauses have been consistent.⁴

The federal contract clause, however, "does not operate to obliterate the police power of the States,"⁵ and correspondingly, the Virginia Constitution declares that the police power of the Commonwealth to regulate the affairs of corporations shall never be abridged.⁶ The police power "is an exercise of the sovereign right of the Government to protect the lives, health, morals, comfort, and general welfare of the people, and is paramount to any rights under contracts between individuals."⁷ The fact that utility rates prescribed by contract may be set aside by the Commission in the exercise of the Commonwealth's police power to

² "No state shall . . . pass any . . . Law impairing the Obligation of Contracts." U.S. Const. art I, § 10.

³ "The General Assembly shall not pass any law impairing the obligation of contracts." Va. Const. art. I, § 11.

⁴ Working Waterman's Ass'n v. Seafood Harvesters, Inc., 227 Va. 101 (1984) (citing 1 A. Howard, Commentaries on the Constitution of Virginia, 203, 207 (1974)).

⁵ Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 241 (1978).

⁶ Va. Const. art. IX, § 6.

⁷ Allied Structural Steel at 241 (quoting Manigault v. Springs, 199 U.S. 473, 480 (1905)).

regulate such rates is well settled, and has been so since the turn of this century. Commonwealth ex rel. Page Milling Co. v. Shenandoah River Light & Power Corp., 135 Va. 47 (1923).⁸

We are particularly perplexed at Sydnor's assertion that "no legitimate public purpose" justifies the impairment of its rights under contract that would occur with Commission regulation of the First Colony system.⁹ Sydnor has reminded us that it is not incorporated as a public service corporation. In enacting the 1974 amendment to § 13.1-620(G), however, the General Assembly clearly showed that it did not choose to surrender the Commonwealth's police power over otherwise unregulated private water companies.¹⁰ It is beyond reasonable

⁸ In support of its holding in Page Milling, the Virginia Supreme Court cites to numerous decisions of other state courts and of the United States Supreme Court. The Court notes that, "[t]hese decisions, a few from many to like effect, should suffice to satisfy the most skeptical or belated investigator that the right of private contract must yield to the exigencies of the public welfare when determined in an appropriate manner by the authority of the State." 135 Va. at 57 (quoting Union Dry Goods Co. v. Georgia Public Serv. Corp., 248 U.S. 372, 377 (1919)).

⁹ Post-Hearing Brief of Sydnor Hydrodynamics, Inc. at 15.

¹⁰ Section 13.1-620(G) requires water or sewer companies serving more than fifty customers to incorporate as a public service company, but it "grandfathers" companies such as Sydnor that were incorporated before and operating a water or sewer system on January 1, 1970. The 1974 amendment to the statute (since further amended) provides the following exception to extend Commission jurisdiction over grandfathered companies:

[A]s to any water or sewer system serving more than fifty customers, upon application to the Commission by a majority of the customers or by the company, a hearing may be held after thirty days' notice to the company and the system's customers or a majority thereof, and the Commission may order such, if any, improvements or rate changes or both as are just and reasonable. Upon ordering into effect any rate changes or improvements found

dispute that Sydnor's privately-owned monopoly water system serving the First Colony subdivision is devoted to a public use, and when private property is so affected, it is subject to public regulation. Munn v. Illinois, 94 U.S. 85, 86 (1877).

For these reasons, we agree with the Examiner that § 13.1-620(G) may be properly applied to Sydnor in its operation of the First Colony system.¹¹ The General Assembly's power to protect the public interest cannot be frustrated by a private desire to have an enterprise affected with a public interest remain immune from the lawful police power of the state to protect the general welfare of the people.

We will next address several accounting issues with which Sydnor takes exception. First, Sydnor objects to the Examiner's recommendation to reduce a Company adjustment for leak repair expense by \$2,487. The reduction results from annualizing the Company's actual repair expense incurred over the six-month test period, during which time the Company experienced fewer leaks than in the past. The annualization results in an expense allowance of \$8,862 for leak repairs. Sydnor sought a total allowance of \$11,349 for this expense based on historical leak

to be just and reasonable, the water or sewer system shall remain subject to the Commission's regulatory authority in the same manner as a public utility for such reasonable period as the Commission may direct. (Emphasis added.)

¹¹ We also adopt the Examiner's finding that § 56-265.11 is not in conflict with, nor does it limit, the application of, § 13.1-620(G).

repair data. We find that the evidence points toward a downward trend in the occurrence of leaks in the future,¹² and therefore we will not accept the Company's adjustment. However, to the extent the test period data may reflect an abnormally low level leak repair expense, we will average the Company's and Staff's recommended allowances and permit a total allowance of \$10,106 for this expense.¹³

The Company also complains that \$371 in costs associated with replacement of water meters should be expensed rather than capitalized, as recommended by the Examiner. In its comments to the Report, Sydnor cites for our convenience the following "Guidelines for Establishing and Maintaining Continuing Property Records" from the NARUC Model Valuation, Plant Costs and Continuing Property Records Manual: "The property units generally fall into four broad categories. First are 'cradle to grave' units such as meters and line transformers. These units are capitalized on purchase and cost of subsequent removing and resetting are charged to expense."¹⁴

¹² See Ex. JLR-1 at 3-5; Ex. JAS-8 at 9-10; Tr. at 73.

¹³ We note that the record before us lacks supporting detail for the Company's proposed adjustment of \$6,918 for leak repair expense. See Ex. BCD-3 at 6-7, Sched. 4; BCD-4 at 12. While we are accepting a significant portion of the Company's proposed adjustment in this instance, it is generally incumbent upon a company to ensure that the record contains sufficient evidence purporting to support its proposed adjustments.

¹⁴ Comments and Exceptions of Sydnor Hydrodynamics, Inc. at 20-21.

The costs at issue are for the replacement, rather than repair, of meters. The cost of labor and minor supplies associated with removing and resetting meters are indeed expensed; however, the meters themselves are capitalized. Since we understand the costs here are associated with materials,¹⁵ we agree with the Examiner that the costs are to be capitalized.¹⁶

The Examiner recommended that Sydnor provide 24-hour toll-free calling for customers to report service problems. Sydnor objects to the Examiner's failure to permit it to include in its cost of service the expense associated with this telephone service. We do not disagree with the Company that it should be able to recover such costs. However, we must deny the Company's request to include such expense in its cost of service because there is no evidence in the record that even begins to establish

¹⁵ Tr. at 89.

¹⁶ This finding is in accordance with the Uniform System of Accounts ("USOA") for Class A Water Utilities which states that the meters account:

shall include the cost of meters, devices and appurtenances attached thereto . . . whether actually in service or held in reserve. It shall also include the cost of labor employed, materials used and expenses incurred in connection with the original installation of a customer's meters and devices and appurtenances attached thereto. A sample of items to be included in this account include: Meters, including badging and initial testing; remote meter registers; installation labor (first installation only); meter coupling; meter bars; meter yokes; meter fittings, connections and shelves; meter vaults or boxes; and stops.

National Association of Regulatory Utility Commissioners USOA for Class A Water Utilities 1996 at 106.

what that cost would be. The Examiner properly found that without such evidence no adjustment can be made to the cost of service for First Colony.

Finally, we find that the Examiner's analyses and recommendations as to rate case expenses are reasonable and should be adopted.

The changes we have made require a total reduction in First Colony's adjusted revenues in the amount of \$2,756. This will afford the Company an opportunity to generate total annual revenues in the amount of \$80,239 and annual net operating income in the amount of \$3,949. We find that aggregate rates designed to produce annual revenues of \$80,239 are just and reasonable and will not provide revenues in excess of actual cost incurred in serving Sydnor's First Colony customers.

We agree with the Examiner's recommendation that the Commission should retain jurisdiction over Sydnor in its operation of the First Colony water system. Pursuant to § 13.1-620(G), we will retain jurisdiction for a minimum of two years from the date of this order, and, during such time, the First Colony system will be subject to our regulatory authority in the same manner as a regulated public utility.¹⁷ We will entertain a motion from the Company after eighteen months from the date of

¹⁷ Our jurisdiction arising out of this proceeding will extend to the First Colony water system only and not to other Sydnor systems.

this Final Order to determine if it is appropriate for the Commission to relinquish jurisdiction at the end of the two-year period.

We will direct Sydnor to file a tariff reflecting rates to produce the revenues approved herein. The Company may maintain existing rules and regulations for service for the First Colony water system that are not inconsistent with this order. Sydnor's contractual provisions relating to rates and rate increases are, however, superseded by the exercise of our authority under § 13.1-620(G) and shall have no effect during the term of the Commission's jurisdiction over the First Colony system. Accordingly,

IT IS ORDERED THAT:

(1) The findings and recommendations of the Chief Hearing Examiner as stated in her October 7, 1998, Report, as modified herein, are hereby adopted.

(2) Consistent with the above referenced findings, the rates for the First Colony water system shall be reduced to effect a revenue reduction of \$2,756 to generate \$80,239 in gross annual revenues, effective April 1, 1997.

(3) The Company's rates and services for the First Colony water system shall remain subject to the Commission's jurisdiction for a period of at least two years from the date of this order.

(4) Within thirty days from the date of this order, the Company shall file with the Division of Energy Regulation a tariff for rates of service consistent with the terms of this order.

(5) On or before August 1, 1999, Sydnor shall refund to customers of the First Colony water system, with interest, as directed below, all revenues collected from the application of the interim rates which were effective for service commencing April 1, 1997, to the extent that such revenues exceeded the revenues which would have been produced by the rates approved herein.

(6) Interest upon the ordered refunds shall be computed from the date payment of each bimonthly bill was due during the interim period until the date refunds are made, at an average prime rate for each calendar quarter. The applicable average prime rate for each calendar quarter shall be the arithmetic mean, to the nearest one-hundredth of one percent, of the prime rate values published in the Federal Reserve Bulletin, or in the Federal Reserve's Selected Interest Rates ("Selected Interest Rates") (Statistical Release G.13), for the three months of the preceding calendar quarter.

(7) The interest required to be paid shall be compounded quarterly.

(8) The refunds ordered in Paragraph 5 above, may be accomplished by credit to the appropriate customer's account for current customers (each such refund category being shown separately on each customer's bill). Refunds to former customers shall be made by a check to the last known address of such customers when the refund amount is \$1 or more. Sydnor may offset the credit or refund to the extent no dispute exists regarding the outstanding balances of its current customer, or customers who are no longer on its system. To the extent that outstanding balances of such customers are disputed, no offset shall be permitted for the disputed portion. Sydnor may retain refunds owed to former customers when such refund amount is less than \$1; however, Sydnor will prepare and maintain a list detailing each of the former accounts for which refunds are less than \$1, and in the event such former customers contact Sydnor and request refunds, such refunds shall be made promptly. All unclaimed refunds shall be handled in accordance with § 55-210.6:2 of the Code of Virginia.

(9) On or before September 1, 1999, Sydnor shall file with the Staff a document showing that all refunds have been lawfully made pursuant to this Order and itemizing the cost of the refund and accounts charged. Such itemization of costs shall include, inter alia, computer costs, and the personnel-hours, associated

salaries and cost for verifying and correcting the refund methodology and developing the computer program.

(10) Sydnor shall bear all costs of the refunding directed in this Order.

(11) This matter shall be removed from the Commission's docket, and the papers placed in the file for ended causes.